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July 24, 1996

Minerals Management Service
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COMMENTS ON PROPOSED REGULATIONS-AMENDMENTS TO GAS VALUATION REGULATIONS FOR FEDERAL LEASES

The Council of Petroleum Accountants (COPAS) again appreciates the opportunity to comment on the MMS proposed rulemaking governing natural gas produced from Federal leases. In addition to commenting on the five options published in the May 21, 1996 Federal Register, pages 25421-25425, comments are submitted to the discussions of the Federal Gas Valuation Negotiated Rulemaking Committee (Committee) meeting held June 12-14, 1996.

COPAS continues to support the original consensus of the Committee. We recognize that some improvements are applicable in order for the original Committee results to be implemented by all parties affected. COPAS also responded to the proposed rulemaking of November 6, 1995. Our recommendations did not change the overall utilization of an alternative gas valuation method. To our dismay, only a few of our comments were acknowledged in the summary of comments received. At the same time, internal MMS concerns and other written comments submitted by states were incorporated in the subsequently proposed options. Many hours were spent by our membership over the fourteen month period to help develop the Committee consensus. This consensus in total included aspects that were not attractive to each of our members, but did result in an overall palatable methodology that could be implemented as an alternative valuation method.

Actions that have occurred since the proposed rule was published, have caused COPAS (and we believe other trade associations) to reassess whether or not we believe it is in our best interest to actively participate in future Negotiated Rulemaking processes. In our current cost conscientious environment, it is very costly and difficult to justify committing such level of resources to a process in which consensus results are negated by the Committee's own members. In the near future, COPAS will be reviewing if its mission can be served by participating in these processes.

The following comments to the five options are part of the minutes of the June 12-14, 1996 meeting of the Committee.

Option 1

Point 1 - COPAS agrees with writing the rule in plain English.

Point 2 - We do not know what the minor procedural and technical improvements may be; therefore are unable to support without review.

Point 3 - Agree with the deletion of this statement.

Point 4 - COPAS continues to recommend the inclusion of an exception for an agreed method by all parties to pay on a method other than takes for 100 percent Federal agreements and stand alone leases.

Point 5 - Delete the 6 months and retain only the 2 years.

Point 6 - Exclude this provision.

Point 7 - Rewrite to read: A refund/credit based on the overtaken volumes by a small producer who paid on takes would be processed through a refund or recoupment based on the actual value of the overtaken volumes.

Point 8 - COPAS supports this recommendation.

Point 9 - COPAS recommends a separate rulemaking for benchmark valuation, but not the proposal as stated in Option 5.

Option 2

COPAS cannot support Option 2 as it is counter to the objectives of the Committee. A review of the Committee Report will demonstrate why industry cannot support any of the provisions of this Option. A lessee calculated safety net based on their own arm's-length sales eliminates the simplicity and certainty which took the Committee many long months of work to achieve. Such a rule with a self-implementing safety net would be worse than the current regulations. All parties would continue to debate what is gross proceeds.

Option 3

Point 1 - Rewrite to read: Index must be applied to the wellhead MMBtu less location differential. There would not be an option to value residue gas based on index. Gross proceeds payors would have the option to apply a gross-proceeds based residue value to the wellhead MMBtu.

Point 2 - Retain the 50% and 65% caps. Cannot live with the elimination of the additional royalty limitation caps without major concessions.
Point 3 - COPAS continues to support the Committee Report which included an option.
Point 4 - Change weighted average to median.
Point 5 - Retain the Committee proposal.
Point 6 - COPAS cannot support a change from the consensus of the Committee Report. Such a change as recommended in this point is totally unacceptable.

Option 4
Point 1 - COPAS continues to emphasize that a regulation requiring a self-implementing, company-based safety net does not recognize the objectives of the Committee and the reasons for the formation of the Committee.
Point 2 - Basically would require dual accounting for payors.
Point 3 - Rewrite to read: Determine the index pricing point using the arithmetic average of index pricing points to which it is physically connected using a single publication.
Point 4 - Should follow Point 3.
Point 5 - See comment to Option 3, Point 6.

Option 5
Totally eliminate this Option.

COPAS actively participated in several meetings with other industry associations to develop the Unified Industry Proposal which was presented at the June 12-14 meeting of the Committee. The above comments to the 5 Options are not to be viewed or interpreted as not supporting the Unified Industry Proposal. (Referred to as Option 6 in the June 12-14 1996 minutes.)

The following comments are to the proposals presented during the Committee meeting of June 12-14, 1996.

New Mexico Proposal
1. For split/multiple connects, determine the IPP using the weighted average method. Retaining no options is unacceptable to COPAS members. Not all companies determine confirmed nominations on a timely basis (as described in the Committee report) and thus need an option. Weighted average is the most complex method and does not reduce complexity of the rule. If a sale occurs prior to the IPP, confirmed nominations are not part of the process. Only one method would require an exception approval system which would increase the MMS burden.

2. Determine the location differential/transportation allowance based on weighted average and actual flow. The location differential would equal lessee's actual costs to IPP. In No Flow situations, index would be applied at the wellhead with no location differential. For non-arm's-length/non-jurisdictional transportation, the allowance would equal lessee's actual cost or the de minimis rate with MMS approval. Index prices are not wellhead prices and thus this method discriminates against no flow producers or a producer who sells prior to the IPP. Also, why should a producer have to request approval from the MMS to use the rate calculated by the MMS.
3. Delete options for index payors to pay index on a wellhead MMBtu and for gross proceeds residue price on a wellhead MMBtu. This proposal increases the complexity for both MMS and industry by requiring the accounting for liquids and eliminates one of the major benefits of the Committee proposal.
4. Delete deepwater exceptions. COPAS definitely opposes.
5. If MMS fails to calculate the safety net in two years, it must keep the states whole. COPAS has no comment.
6. Committee consensus would apply to gathering and transportation. COPAS agrees.

Wanda's Proposal

1. Value royalties on index in accordance with the Consensus Rule, including wellhead MMBtu reporting, but without a location differential or transportation allowance. Eliminate the safety net calculation and associated true-up. This proposal eliminates a cost that MMS has traditionally allowed as a deduction from the royalty settlement. COPAS strongly opposes and states that this is not an acceptable amendment to the valuation regulations.
2. No exception for gross proceeds payors to value small volumes of non-sale (NAL) dispositions on NAL benchmarks rather than index. The Committee reached agreement to use the benchmarks for valuation.
3. Committee consensus would apply to gathering and transportation. COPAS agrees.

MMS/State Proposal

1. Index/No Location Differential/No Safety Net. Refer to COPAS comments to Point 1 of Wanda's Proposal.
2. Determine the IPP using the weighted average method. Refer to COPAS comments to Point 1 of New Mexico's Proposal.
3. The Indexing Pricing Point would be determined by using any single valid publication. COPAS supports this recommendation.
4. Use the Committee consensus for gathering/compression. COPAS supports this point.
5. For index payor, allow wellhead MMBtu reporting on processed gas. If this statement is only to clarify that valuation at the wellhead eliminates the tracking of NGL's, then COPAS supports this statement.

6. For mixed agreements, producers whose total monthly royalty payments on federal leases total less than $5000.00 qualify to pay on takes. This dollar amount was a spur of the moment statement and should not be considered. The Committee agreed that a meaningful exception to entitlements should be provided for small producers. The MMS is to study this issue and determine the amount for the exception.
7. No location differential. Refer to the COPAS comment on Point 1 of this proposal.

MMS/State Modified

1. Index payors would true up to 100% (no safety net cap) of the MMS calculated safety net value. The safety net value would be the weighted average of a stratified sample of arm's-length gross proceeds (including affiliate resale proceeds) accruing to gross proceeds payors and index payors in the zone. The safety net would be published in two years based on audited product codes 03 and 04. COPAS opposes the use of the weighted average of the gross proceeds payors in calculating the safety net as it does not eliminate price anomalies. Also, COPAS does not believe that the gross proceeds payors payments can be audited in a two year period. This point continues to include all the gross proceeds issues that index valuation was trying to eliminate. COPAS strongly disagrees with the 100% cap and believes that the stratified sample is a significant deviation from the intent of the Committee. COPAS would request further information on the stratified sample before it could consider this method.
2. Determine the IPP using the weighted average method. Refer to the COPAS comment to Point 1 of New Mexico.
3. The Index Pricing Point would be determined by using any single valid publication. COPAS continues to support.
4. Use the Committee consensus for gathering/compression. COPAS continues to support.
5. In order to report and pay processed gas royalty on a wellhead MMBtu basis, add 2% to the applicable index or gross proceeds residue price. COPAS disagrees with the additional 2% as is not representative of the total universe and should not be applied without consideration for the zone in which valuation is occurring.
6. For mixed agreements, producers whose total monthly royalty payments on federal leases total less than $5000.00 quality to pay on takes. The Committee agreed that a meaningful exception to entitlements should be provided for small producers. The MMS is to study this issue and determine the amount of the exception.
7. Arm's-length and jurisdictional transportation allowances should be based on the actual rate paid. Non-arm's-length, non-jurisdictional transportation allowances should be limited to actual costs, or a de minimis rate with prior MMS approval. Refer to the COPAS comment to Point 1 of New Mexico.

COPAS continues to support the Committee consensus with the modifications that create a regulation that answers the majority of all parties concerns but at the same time provides simplicity and certainty for valuation of federal gas. To place an increased administrative burden on any one party is only shifting the complex issues that the Committee worked to eliminate. COPAS also encourages the MMS to implement the final rule six months from the date of publication and not wait until the beginning of the next year.

COPAS encourages the MMS to review our original comments submitted on January 25, 1996. The majority of our comments were clarification points and not controversial. Should there be any questions regarding these comments or the previous comments, please contact me at 405/767-5044.

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